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In the Supreme Court of the United States.

OCTOBER TERM, 1914. No. 197.

Norfolk and Western Railway Company, Complainant Below and Appellant,

vs.

W. G. Conley, Attorney General of the State of West Virginia, et al., *Respondents Below and Appellee.*

REPLY BRIEF OF COUNSEL FOR NORFOLK AND WESTERN RAILWAY COMPANY.

The brief of the Attorney General on behalf of the State of West Virginia argues three points, designated I, (*a*) and (*b*), and II. We shall use the same designation.

I

"(a) Does the Railroad Properly Show the Capital Invested in Its Intrastate Passenger Service Used and Useful in That Service?"

The argument of this point commences with the intimation that tax value does not afford an adequate basis for the determination of the fair value of property when testing the reasonableness of State regulation. The Missouri Rate Cases of Knott *vs.* C., B. & Q. R. R. Co., 230 U. S., 474, are relied upon, in which Mr. Justice Hughes pointed out defects in the assessed valuation as not a correct guide in that case. The value taken there was the value ascertained "by the state assessing board, for the purpose of taxation, multiplied by 3," the assessment being supposed to be on the basis of one-third of the value. Other companies in the case had values found at *twice* the assessed value. In West Virginia the assessment is required by the statute to be made at the "true and actual value" (West Virginia Code of 1906, Section 696). The principles governing the West Virginia assessments of railroads are set forth in Hogg's West Virginia Code, Vol. I, Sections 968 and 969, which sections are printed in the Appendix, No. 2 of this brief. There was not here any artificial value based on doubling or trebling an assessment.

Another contention under point (*a*) by the State is that the *division* of capital as between intrastate passenger business and other business in West Virginia of this complainant by gross earnings was inaccurate. Our opponents urge that as this division is not "an accurate measure" (the Minnesota Rate Cases, 230 U. S., 352, at page 459) of value of the use, so the evidence of the Company's witness based thereon is not sufficient to prove confiscation.

To this and the preceding criticism we reply that the witness for the State reached the result of confiscation by the method of comparing expenses with earnings (without the necessity of finding total or divided capital) so that as stated by this Court in The Minnesota Rate Cases (Opinion of Mr. Justice Hughes as to M. & St. L. R., 230 U. S., at page 472):

> "It is not necessary here to reproduce the computations, as we are satisfied, after a careful examination of the evidence, that while the methods of estimating value, and of apportionment, which have been disapproved in the discussion of the cases of other companies, are subject to the same objections in this case, so far as they have been employed, the margin of error which may be imputed to them is not sufficiently great to change the result."

And in finding confiscation as to certain railroads in Knott *vs.* C., B. & Q. R. R. Co., 230 U. S., 474 (The Missouri Rate Cases at pages 507-8), Mr. Justice Hughes, writing the opinion of this Court, said:—

> "The exceptions are these: In the case of the St. Louis & Hannibal Company, operating, as found by the court below, 120.61 miles, within the state, the net revenue from the entire Missouri business, interstate and intrastate, for the fiscal year ending June 30, 1908, appears to have been $15,687.18. In the case of the Kansas City, Clinton, and Springfield Company, operating 151.01 miles within the state, the net revenue from the entire business therein, interstate and intrastate, for the same year amounted to $32,500.72. In each of these cases the experts employed by the parties unite in the statement that it is apparent from the results shown that 'upon neither the revenue nor ton mile nor passenger mile theory of expenses can any adequate return on the investment be earned.'
>
> "In the case of the Chicago Great Western Company, operating 84.43 miles of road within the state, the entire net revenue from the Missouri business, interstate and intrastate, for the six months ending December 31, 1907, being the period taken by both parties for the purpose of calculation, amounted to $41,839.06. From our examination of the

> evidence and the various computations we are satisfied in this case, as in the two others above-mentioned, that errors attributable either to valuation or to apportionments cannot be regarded as sufficiently great to change the result."

The case at bar is a case such as was suggested by this Court in the Minnesota Rate Cases (230 U. S., 352, at page 459):—

> "Doubtless there may be cases where the facts would show confiscation so convincingly in any event, after full allowance for possible errors in computation, as to make negligible questions arising from the use of particular methods."

In the case at bar the witnesses for both sides, using different methods, arrived at the result that the two cent rate is not remunerative to this Company on intrastate passenger business in West Virginia. Mr. Hillman, the State's witness, in distributing expenses adopted comparable use-units intended to conform to the principle later suggested by this Court in the Minnesota Rate Cases for the division of capital. (Opinion of Mr. Justice Hughes, 230 U. S., 352, at page 461):

> "When rates are in controversy it would seem to be necessary to find a basis for a division of the total value of the property in-

> dependently of revenue, and this must be found in the use that is made of the property. That is, there should be assigned to each business that proportion of the total value of the property which will correspond to the extent of its employment in that business. It is said that this is extremely difficult; in particular, because of the necessity for making a division between the passenger and freight business, and the obvious lack of correspondence between ton-miles and passenger-miles. It does not appear, however, that these are the only units available for such a division; and it would seem that, after assigning to the passenger and freight departments respectively, the property exclusively used in each, comparable use-units might be found which would afford the basis for a reasonable division with respect to property used in common."

Finally, a finding of total capital or a division of capital is unnecessary in the case at bar because all the evidence proves by comparison of expenses with earnings that there is practically no return upon capital irrespective of amount invested.

In the appendix, No. 1, of this brief we have printed for the convenience of the court a summary with page references to the record of the evidence for both sides which proves confiscation as to intrastate passenger business.

"(b) Does the Railroad Company Properly Show the Earnings and Expenses Derived from and Chargeable to Its Intrastate Passenger Business?"

This branch of the Attorney General's argument opens with the assertion that to West Virginia in determining confiscation should be credited that part of the *interstate* passenger revenue which was earned by such portions of interstate passenger hauls as were made in West Virginia. In Smyth *vs.* Ames, 169 U. S., 466, this Court decided that reasonableness or unreasonableness of rates prescribed by a State for the transportation of persons or property wholly within its limits must be determined without reference to the *interstate* business done by the carrier.

On page 6 of the Attorney General's brief the method of distributing expenses in and out of West Virginia by mileage where a division crosses the state line is criticized. Hypothetical cases not in evidence are suggested wherein such a method might conceivably be unfair either to West Virginia or to the part of the division outside that State. There is no evidence to show that the distribution of expenses described by the witnesses in the record were un-

fair for these exceptional reasons. On the contrary, the uncontradicted testimony is that the divisions were substantially the same in character, the expenses of which have been distributed on a mileage basis inside and outside the State.

At pages 7 to 9, inclusive, of the Attorney General's brief, criticism is offered of the distribution as between intrastate passenger business and other classes of business of certain items of expense. Greater accuracy at page 10 is claimed for Mr. Hillman's method as "based on actual percentages, conditions, and a thorough analysis of the expenses under consideration."

In Point (a) of I we have shown that in this case confiscation (if segregation of the intrastate passenger business from the other business of the Company is correct) is proven and admitted.

II

"Should the Railroad Company be Allowed to Segregate Its Intra Passenger Earnings from All Other Earnings in the State in Its Attempt to Show Confiscation?"

The brief of the Attorney General under this head opens with the suggestion that all intrastate rates, freight and passenger, are regulated by law in West Virginia. His suggestion

is that the Two Cent Rate Act, which was a separate act of the legislature, is but a part of a general regulation of all rates by statute.

The history of maximum rate legislation in West Virginia is this:

By an act passed 27 December, 1873 (Acts of West Virginia 1872-3, page 710) maximum freight and passenger rates were fixed. By an act passed 16 February, 1895 (Acts of West Virginia 1895, page 32) maximum freight rates were fixed, thereby, by implication, repealing the act of 1873 *as to maximum freight rates.* By an act passed 20 February, 1907, (Acts of West Virginia 1907, page 226) the Legislature fixed for all railroads over fifty miles in length a maximum passenger rate of two cents per mile, and thereby repealed by implication the provisions of the act of 1873 *as to passenger rates.*

The Attorney General points out that the Supreme Court of West Virginia in Coal & Coke Ry. Co. *vs.* Conley, 67 W. Va. at page 174, found that the Two Cent Passenger Rate Act of 1907 was "an amendment by implication, repealing existing laws so far, and only so far, as it is inconsistent therewith"; and was "an amendment of the other statutes relating to the subject matters thereof in existence at the date of its passage." Thereupon the Attorney General, partly on the authority of the Minnesota Rate Cases, urges that

the Two Cent Rate Act "should not be segregated, but considered as a part of and in the light of the entire state legislation regulating passenger and freight rates."

Let us first examine the assertion that this Court declined to allow segregation in the Minnesota Rate Cases, *supra*. From the opinion of Mr. Justice Hughes in those cases the Attorney General quotes (230 U. S. at page 466) a passage wherein this Court declined to express any opinion with respect to the method adopted in dividing expenses between the passenger and freight departments, and stated that "for the purpose of determining whether the rates permit a fair return, the results of the entire intra-state business must be taken into account." The case before the court was to restrain the enforcement of two orders of the Railroad and Warehouse Commission fixing maximum freight rates, and two acts of the Legislature prescribing maximum charges for the transportation of freight and passengers. One of the acts was a two cent maximum passenger rate act. But the railroads did not have their accounts in such condition as to distribute the expenses with reasonable accuracy as between the passenger and the freight business. Moreover, the separation of expenses by the system of accounting of those particular railroads into interstate and intrastate

had not been made. Only theories or estimates not based on actual accounts were presented to the court, and for this reason the court only considered those general results from the whole business intrastate which were shown by actual figures. That segregation, where practicable, is not condemned but is essential will appear from this extract from the opinion of Mr. Justice Hughes at page 467:

> "We are of opinion that, on an issue of this character, involving the constitutional validity of state action, general estimates of the sort here submitted, with respect to a subject so intricate and important, should not be accepted as adequate proof to sustain a finding of confiscation. While accounts have not been kept so as to show the relative cost of interstate and intrastate business, giving particulars of the traffic handled on through and local trains, and presenting data from which such extra cost as there may be, of intrastate business, may be suitably determined, it would appear to have been not impracticable to have had such accounts kept or statistics prepared, at least during test periods, properly selected. It may be said that this would have been a very difficult matter, but the company, having assailed the constitutionality of the state acts and orders, was bound to establish its case, and it was not entitled to rest on expressions of judgment when it had it in

> its power to present accurate *data* which would permit the court to draw the right conclusion.

As the railroads had, in the language of Mr. Justice Hughes, "assailed the constitutionality of the state acts and orders" the railroads were held bound to establish their case by evidence, and the evidence in that case was found to consist of artificial estimates based on the judgment of the witnesses instead of upon accurate data such as would permit the court to draw the right conclusion. In the case at bar the proofs were definite. nite.

The fact is that the railroads in the Minnesota Rate Cases assailed the whole rate making scheme, and that there was no segregation as between intrastate passenger and intrastate freight business.

The argument of the Attorney General in the present case that if the business, freight and passenger, of this company, intrastate, shows a reasonable return, that then, necessarily, both branches of that business must make a reasonable return, is an argument which this Court has rejected. In the Minnesota Rate Cases this Court (230 U. S. at page 435) declined to accept the theory advanced by the State of Minnesota, that the interstate and intrastate earnings in Minne-

sota should be considered in determining confiscation, and said:

> "The reason * * * is that the state cannot justify unreasonably low rates for domestic transportation, considered alone, upon the ground that the carrier is earning large profits on its interstate business."

So here, the state cannot justify the confiscation of property devoted to the intrastate passenger service merely because some other branch of the company's business, state or interstate, is reasonably profitable.

The ruinous effect *pro tanto* of such confiscatory rate legislation can only result in depriving the railroad of its just revenue from other presumably reasonable rates.

Perhaps it ought to be noted that a reasonable return is not a fixed figure, but varies from the point of confiscation up to the maximum reasonable return. Confiscatory intrastate passenger rates cannot be justified by taking away the company's revenues from some other source.

Not only should segregation be allowed, but it will be required as a condition of relief. Relief in the notable Alabama Cases was denied to the carrier because of a failure to segregate the intrastate passenger earnings and cost: L. & N. R. Co. *vs.* Railroad Commission of Alabama, 208 Fed. 35. In

those cases on motion for preliminary injunction the opinions of the Judges held in substance that segregation of the intrastate passenger business must be made and that the whole of the intrastate business, freight and passenger, could not be considered in order to determine whether the maximum passenger rate of 2½ cents per mile prescribed by the Commission was confiscatory. At page 41 the Court said:

> "The plaintiff cannot be permitted to cause the failure of return by its own acts and then complain of it. For the encouragement of the manufacture of iron and its products in the Birmingham district, the plaintiff carries coal, ore, and limestone at cost, or at a loss, so far as intrastate traffic is concerned. This traffic carried without profit constitutes more than 75 per cent. of all the plaintiff's intrastate tons in Alabama. Eighty per cent. of the plaintiff's mileage in Alabama consists of branch lines, constructed, it is shown, with knowledge that they would not pay from intrastate business a fair return upon their value."

See also the case heard at the same time by the same Judges of S. & N. A. R. Co. *vs.* Railroad Commission of Alabama, 210 Fed. 465.

The Attorney General cites cases such as Atlantic Coast Line Railroad Company *vs.* North Caro-

lina, 206 U. S., 1, for the point that a railroad company may be required to maintain a particular service (in that case a daily passenger train) at a loss. Cases of this class have no bearing on the question of segregation. They were cases where the question was not one of rates but one of the performance by the carrier of a public duty. It has long been established that a carrier must perform its public duty even though at a loss.

Another class of cases cited by the Attorney General is such cases as Minneapolis and St. Louis R. Co. *vs.* Minnesota, 186 U. S., 257. The carrier attempted to show that a particular coal rate regulated by the State of Minnesota was too low. The proofs went no further than to show that the same rate on a tonnage basis applied to the whole business of the Company would have rendered that business unprofitable. These proofs were held insufficient to entitle the carrier to relief because "it by no means follows that the companies are entitled to earn the same percentage of profits upon all classes of freight carried," and also because it is not "beyond the power of the state commission to reduce the freight upon a particular article, provided the companies are able to earn a fair profit upon their entire business and that the burden is upon them to impeach the action of the commission in this particular." The carrier failed in

its attack upon this coal rate because of the failure of its proof that the particular coal rate so fixed was confiscatory.

At page 23 of his brief of argument the Attorney General makes this argument:—

> "If its intra passenger business is not remunerative, it follows that its freight business is more than remunerative, and it is charging unjust and unreasonable rates for its freight. In one branch it claims injustice, while in the other branch it is admittedly perpetrating that same injustice, and appeals to a court of equity."

This argument is founded upon an error which this Court had occasion to expose in M. & St. L. R. Co. *vs.* Minnesota, 186 U. S. 257, pointing out that "it by no means follows that the companies are entitled to earn the same percentage of profit upon all classes of freight carried," etc. It is perhaps not improper to add, in response to the suggestion that on some of its business the Company must be earning a greater rate than a reasonable one, the statement as to the carrier here seeking relief, the Norfolk and Western Railway Company, of the duly constituted federal tribunal, the Interstate Commerce Commission in the Lake Cargo Coal Rate Case, 22 I. C. C. Rep.,

604 (decided March 11th, 1912), at page 625, in authorizing an advance of the lake coal rate:—

> "A further consideration which moves us to permit these advanced rates is that we regard it as unfair to take from the carrier whatever of profit it may secure by reason of improvement in its plant and adoption of the most modern methods. If our railroad systems are to remain in private hands, stimulus must be given to the initiative and imagination of railroad operators. The community may not take with justice whatever comes by the labor or time-saving devises adopted by those who serve the public, nor may the carriers absorb the profits of the shipper resulting from similar effort. This road is one of the most prosperous in the country, and it is largely so because of the enterprise of its officials in developing a great business and in handling it in the most economical method."

At page 21 of his brief of argument the Attorney General asserts that the Norfolk and Western "should not be allowed to separate its intra passenger business from the great bulk of its operations." This is the State's case in final analysis.

If segregation is permitted, as it must be under the authorities and upon principle, confiscation is established without controversy by all the proofs in the case at bar.

JOSEPH I. DORAN,
THEODORE W. REATH,
JOHN H. HOLT,
LUCIAN H. COCKE,
Of Counsel for Norfolk and Western Railway Company.

OCTOBER, 1914.

APPENDIX No. 1.

SUMMARY OF THE EVIDENCE FOR BOTH SIDES AS TO THE COST OF DOING INTRASTATE PASSENGER BUSINESS IN WEST VIRGINIA.

EVIDENCE OF MR. COXE, THE COMPTROLLER OF THE NORFOLK AND WESTERN RAILWAY COMPANY:

The Norfolk and Western Railway Company since its organization in 1896 has maintained a system of accounting in this respect differing from the great majority of the roads, whereby it separates the costs expended in conducting its passenger and freight business. As the result of the experience of these years, it has ascertained that about 65% of such expenditures can be allocated and are allocated in its daily accounting. The residue or unallocated expenses are distributed, in the final scummary, between passenger and freight, on the basis of engine miles.

The result of this accounting for the year ended June 30, 1909, is shown in J. W. C. Exhibit D-2, page 121 of the Record:

Operating Revenues including By-Products, (Mail, Express and Excess Baggage)		$355,505.10
Add Miscellaneous Income		1,345.91
		356,851.01
Operating Expenses, excluding Taxes		345,053.25
Operating Ratio, excluding Taxes		96.70%
Adding Ratio represented by Taxes:	$ 12,413.87 / $356,851.01 =	3.49%
Operating Cost including Taxes		100.18%

This exhibit also shows the cost per passenger per mile to be 2.365 cents, which is obtained by dividing the intrastate passengers one mile into the operating expenses for that year.

Operating Expenses (excluding Taxes ... $345,053.52 / Passengers One Mile ... 14,592,621 = 2.365 Cents

EVIDENCE OF MR. HILLMAN FOR THE STATE.

The unallocated items of expense, about 35%, were divided by Mr. Hillman on the basis of use-

units. He took up each one of the 116 accounts of the company which were kept as prescribed by the Interstate Commerce Commission, and divided each item of expense between the passenger and freight business of the Railway Company according to the use by each department of the particular items of expenditure. This he did in detail.

The final result of his analysis of the cost of doing the intrastate passenger business in West Virginia appears in his exhibits (between pages 244 and 245 of the record), the final summary of which is found in Exhibit No. 6, as follows:—

Operating Ratio, excluding Taxes, on Intra-State Passenger Business including By-Products (Mail, Express and Excess Baggage)	93.3754%
Adding Ratio represented by taxes,	4.0449%
Operating Cost including Taxes,	97.4203%

His conclusion, accordingly, was that practically the whole revenue from intrastate passenger business of the Norfolk and Western Railway Company in West Virginia was absorbed by the cost of doing that business. (See for his conclusion the testimony of Mr. Hillman, Record page 213).

APPENDIX No. 2.

LEGISLATION OF WEST VIRGINIA AS TO ASSESSMENT OF RAILROADS. HOGG'S WEST VIRGINIA CODE ANNOTATED, VOLUME 1, CH. 29, SECTIONS 968 AND 969 (PAGES 404-405).

Sec. 968. Public Service Corporations—Returns of Property to Board of Public Works.

84. On or before the first day of April in each year a return in writing to the board of public works shall be delivered to the state tax commissioner by the owner or operater of every railroad, wholly or in part within this state; by the owner or operator of every railroad bridge upon which a separate toll or fare is charged; by the owner or operator of every car or line of cars used upon any railroad within the state for transportation or accommodation of freight or passengers, other than such owners or operators as may own or operate a railroad within the state; by the owner or operator of every express company or express line, wholly or in part within this state, used for the transportation by steam or otherwise of freight and other articles of commerce; by the owner or

operator of every pipe line, wholly or in part within this state, used for the transportation of oil or gas or water, whether such oil or gas or water be owned by such owner or operator or not, or for the transmission of electrical or other power, or the transmission of steam or heat and power or of articles by pneumatic or other power; and by the owner or operator of every telegraph or telephone line, wholly or in part within this state, except private lines not operated for compensation. The words "owner or operator" as applied herein to railroad companies shall include every railroad company incorporated by or under the laws of this state for the purpose of constructing and operating a railroad, or of operating part of a railroad within this state, whether such railroad or any part of it be in operation or not; and shall also include every other railroad company, or persons or associations of persons, owning or operating a railroad or part of a railroad in this state on which freight or passengers, or both, are carried for compensation. The word "railroad," as used herein includes every street, city, suburban or electric or other railroad, or railway. The word "owner or operator," as applied herein to express companies shall include every express company incorporated by or under the laws of this state, or doing business in this state, whether incorporated or not, and any per-

son or associations of persons, owning or operating any express company or express line upon any railroad or otherwise, doing business partly or wholly within this state. Such return shall be signed and sworn to by such owner or operator if a natural person, or, if such owner or operator shall be a corporation, shall be signed and sworn to by its president, vice-president, secretary or principal accounting officer, and shall show in detail particulars as hereinafter set forth, for the year ending on the thirty-first of December next preceding.

Sec. 969. Same—Railroads—Returns—Contents.

85. In the case of a railroad, such return shall show for every such owner or operator;

(*a*) The whole number of miles of railroad owned, leased or operated within this state.

(*b*) If such railroad be partly within and partly without this state, the whole number of miles within this state, and the whole number of miles without the same, including its branches in and out of the state;

(*c*) The railroad track in each county in this state through which it runs; giving the whole number of miles of road in the county, including the track and its branches and side and second

tracks, switches and turnouts therein, and the true and actual value per mile of such railroad in each county, stating the valuation of main track, second main track, branches, sidings, switches and turnouts separately;

(*d*) All rolling stock owned, leased or operated, showing in separate classes: (1) The rolling stock owned; (2) the rolling stock leased or held under any conditional sale or other contract, giving such owner or operator the possession or control thereof: (3) the rolling stock used upon the line of such owner or operator, but owned by other railroad companies not owning or operating a railroad wholly or in part within this state; and (4) the rolling stock used upon such line, but owned, held or operated by corporations or companies not railroad companies, or by individuals, and for each of said classes giving a detailed statement of the number and ownership of engines, car lines and cars, including passenger, mail, express, baggage, freight, sleeping, dining, parlor, refrigerator, stock and other cars of every description, and the names and addresses of the owners, and the true and actual value of all such cars used wholly or in part in this state, distinguishing between those used wholly in this state and those used partly within and partly without the state; the whole number of engines, including their appendages, used wholly or in part within

this state, distinguishing between those used wholly within this state and those used partly within and partly without the same, and the true and actual value of those used wholly within the state and those used partly within and partly without the state; and the proportional value of cars and engines used partly within and partly without the state, according to the time used and the number of miles run by such cars and engines in and out of the state; and the proportional value thereof in each county in this state within which such railroad runs;

(*e*) the depots, station houses, section houses, freight houses, machine and repair shops and machinery therein, and all other buildings, structures and appendages connected thereto or used therewith, including tool houses and the tools usually kept therein, together with all other real estate, other than railroad track, owned or used in connection with the railroad, and not otherwise taxed, including telegraph and telephone lines owned or used, and the true and actual value of all buildings and structures, and all such machinery and appendages, and each parcel of such real estate, including such telegraph or telephone lines, and the true and actual value thereof in each county in this state in which it is located;

(*f*) personal property, of every kind whatsoever, including money, credits and investments

wholly held or used in this state, showing the amount and value thereof in each county;

(*g*) an itemized list of all other real property, with the location thereof, which list shall show as to each parcel whether it is assessed for taxation, and if so, by what officer or authority;

(*h*) the capital actually employed; the total amount of bonded indebtedness, and of indebtedness not bonded; gross earnings for the year, including earnings from telegraph lines, which shall be stated separately, on the whole length of road, including the branches thereof, in and out of the state, and also such earnings within the state on way freight and passengers, and the proportion of such earnings in this state on through freight and passengers carried over lines in and out of the state, to be ascertained by the number of miles the same was carried within and the number of miles without the state; and, if such owner or operator be a corporation, its actual capital stock, and the number, character, amount and market value of the shares thereof, and the amount of capital stock actually paid in;

(*i*) gross expenditures for the year, giving a detailed statement thereof under each class or head of expenditures.